Salvatore Rossi: Monetary policy and the independence of central banks – the experience of the European Central Bank in the global crisis

Speech by Mr Salvatore Rossi, Senior Deputy Governor of the Bank of Italy, at the University of Verona, University complex of Vicenza, Vicenza, 19 November 2014.

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1. The independence of central banks in theory and in history[1]

We have been talking about the independence of central banks almost from the time of their inception. In an essay of 1824 David Ricardo accused the Bank of England, founded more than a century earlier, of submitting to the power of the executive.[2] Ricardo identified the three pillars of central bank independence: institutional separation of the power to create money from the power to spend it; a ban on the monetary funding of the State budget; and the central bank's obligation to give an account of its monetary policy.

Ricardo's suggestions were taken up by the Brussels Conference of 1920, held under the aegis of the League of Nations with the aim of identifying the best policies to counter the economic and financial crisis that followed the First World War. Price stability was indicated as the primary objective of monetary policy but – as the Final Report of the conference maintained – if it was to be achieved, it had to be entrusted to central banks that were independent of their governments.[3]

These principles were forgotten for many years after the Second World War. The conviction that a certain degree of inflation was necessary to support employment and growth came to the fore in economic thought and in the minds of policy makers. In many countries monetary policy was dominated by budgetary requirements (fiscal dominance) and central banks acted as buyers of last resort of government securities when they came onto the primary market.[4] The independence of central banks enjoyed little institutional protection.

The stagflation of the 1970s suddenly brought to light what farsighted economists, such as Edmund Phelps, had already foreseen in the previous decade:[5] in the short term there may be a trade-off between inflation and unemployment, but not in the long term. This radical rethinking of the theory was accompanied by profound changes in the organization and behaviour of central banks.

Economic literature once again looked at price stability as a supreme value and pointed to two prerequisites: the independence of the institutions called to guarantee it, i.e. central banks, and the adoption on their part of explicit objectives.

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1 This section is based in part on Salvatore Rossi (2013), "Post-crisis challenges to central bank independence", speech given at the LBMA/LPPM Precious Metals Conference http://www.bancaditalia.it/interventi/intaltri_mdir/300913/rossi_300913.pdf.

2 David Ricardo (1824), *Plan for the Establishment of a National Bank*, John Murray, London.

3 Franco Spinelli and Carmine Trecroci (2006), "Maastricht: New and Old Rules", *Open Economies Review*, Vol. 17, pp. 477–492.

4 For the Bank of Italy, see Eugenio Gaiotti and Alessandro Secchi (2013), "Monetary policy and fiscal dominance in Italy from the early 1970s to the adoption of the euro: a review", Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, No. 141.

5 See Edmund S. Phelps (1967), "Phillips Curves, Expectations of Inflation and Optimal Unemployment over Time", *Economica*, Vol. 34, pp. 254–281 and Edmund S. Phelps (1968), "Money-Wage Dynamics and Labor-Market equilibrium", *Journal of Political Economy*, Vol. 76, pp. 678–711.

The need for a central bank to declare an explicit objective, thus making it more difficult for the political authorities to change it, was already mentioned in an article by Milton Friedman of 1962 entitled, significantly, "Should there be an independent monetary authority?"[6] Friedman asks "how else can we establish a monetary system that is stable, free from irresponsible governmental tinkering and incapable of being used as a source of power to threaten economic and political freedom." He counted on independent experts, although he ruled out entrusting them with wide powers of discretion, preferring fixed rules that assign precise tasks and objectives to monetary policy.

In the 1970s Robert Lucas, Thomas Sargent and others complicated the picture: they did not think it was sufficient to assign the task of maintaining price stability to the central bank; private agents have rational expectations, therefore monetary policy must be time consistent to be credible.[7] A government will always be tempted to exploit the short-term trade-off between growth and inflation, without worrying about the long-term costs. To avoid this risk a central bank has to be really independent.[8] Numerous empirical checks supported these theoretical assumptions.[9]

2. The European system of central banks

The Maastricht Treaty, signed in 1992, drew on this new paradigm.

Article 127 of the current version of the Treaty on the Functioning of the European Union, which incorporated the principles enshrined in the Treaty of Maastricht, establishes that "The primary objective of the European System of Central Banks (ESCB) … shall be to maintain price stability".[10] The Governing Council of the European Central Bank (ECB) later explained that price stability should be understood as an inflation rate below, but close to, 2 per cent in the medium term.

Instead independence is affirmed in Article 130, which states that "…neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks."

The Treaty thus establishes the obligations both for the monetary policy authorities, which cannot bend to political pressure, and for governments, which cannot exercise it.

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6 Milton Friedman (1962), "Should There Be an Independent Monetary Authority?", in Leland B. Yeager (ed.) *In Search of a Monetary Constitution*, Harvard University Press, Cambridge, Massachusetts.

7 See, among others, Robert Barro and David Gordon (1983), "Rules, Discretion, and Reputation in a Model of Monetary Policy", *Journal of Monetary Economics,* Vol. 12, No. 1, pp. 101–122.

8 See, for example, Kenneth Rogoff (1985), "The Optimal Degree of Commitment to an Intermediate Monetary Target", *Quarterly Journal of Economics*, Vol. 100, No. 4, pp. 1169–1189 and Carl E. Walsh (1995) "Optimal Contracts for Central Bankers", *American Economic Review*, Vol. 85, No. 1, pp. 150–167.

9 Alberto Alesina and Lawrence H. Summers (1993), "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence", *Journal of Money, Credit and Banking*, Vol. 25, No. 2, pp. 151–162.

10 Article 127 also states that "Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the union as laid down in Article 3 of the Treaty on European Union", which include full employment. On the ranking of the ESCB's objectives, see, however, Perassi (2011), "La Banca centrale europea", published in *Enciclopedia del diritto*, Annali IV, Giuffrè Editore, Milan.

It is interesting to note that the Treaty endorsed the proposal that Ricardo had formulated almost two centuries earlier, providing the legal basis for the three principles he developed.

The institutional separation between the public powers of creating and spending money was established under Article 128, which states that "The European Central Bank shall have the exclusive right to authorize the issue of euro banknotes within the union." Monetary funding of the State is prohibited by Article 123: "Overdraft facilities or any other type of credit facility … in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them … of debt instruments." Lastly, Article 284 obliges the ECB to send an annual report to the European Parliament, the Council and the Commission.[11] This reporting requirement, linked with a clear mandate, means that the monetary policy authority can be evaluated ex-post and is therefore accountable.

So far we have looked at the regulations. What about the substance?

A questionnaire was sent out at the end of the 1990s to a large number of central banks, which were asked what independence meant to them. Some 80 per cent of the replies to this question mentioned the freedom of the central bank to choose the most suitable instruments for its objectives;[12] in short, real operational independence. We should not be surprised: it has been said that the practice of central banking is more of an art than a science.[13] In the field of the natural sciences, specific operational instruments follow from quantitative analysis. Monetary policy also makes use of models, but it cannot do without qualitative evaluations. Paul Samuelson said, "I would rather have Bob Solow than an econometric model, but I'd rather have Bob Solow with an econometric model than Bob Solow without one."

The Statute of the ESCB and the ECB permits them to use a wide range of instruments and to choose any method of monetary control they consider appropriate.[14] We know however that real functional independence can only be evaluated on the basis of past experience: we need to check that the instruments available to the central bank, albeit numerous, are not in fact insufficient to address unexpected problems and to be sure that at the moment the need emerges for new instruments there will not be any constraints on operational autonomy.

3. The Eurosystem and the global financial crisis

The long period known as the Great Moderation, lasting up to the outbreak of the global financial crisis, did not provide a good test of the efficacy of the Statute and operating arrangements of the Eurosystem. Central banks in all the advanced countries successfully

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[11] Other reporting obligations are dealt with in Article 15 of the Statute of the ESCB and the ECB, which requires the ECB to draw up and publish reports on the activities of the ESCB at least quarterly.

[12] Lavan Mahadeva and Gabriel Sterne (2000), *Monetary Frameworks in a Global Context*, Routledge, London. There were 60 replies, of which 23 from advanced countries and 37 from emerging and developing countries.

[13] See Alan Blinder (1997), "What Central Bankers Could Learn from Academics-and Vice Versa", *Journal of Economic Perspectives*, Vol. 11, No. 22, pp. 17.

[14] Article 18 of the Statute of the ESCB and the ECB attached to the Treaty affirms that they may "operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in Community or in non-Community currencies, as well as precious metal and conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral." Article 20 authorizes the Governing Council to decide, by a majority of two thirds of the votes cast, upon the use of such other operational methods of monetary control as it sees fit.

preserved price stability with conventional policy instruments, thanks to such formidable facilitating factors as the rise of the emerging economies and the intense downward pressure on prices that they exerted. The crisis changed everything.

The exceptional monetary expansion that was required of the central banks, still haunted by the spectre of the errors committed during and after the Great Depression in the 1930s, required unconventional policy measures: unlimited provision of liquidity, purchases of government and private-sector securities on the secondary market, currency swaps, forward guidance, and much more.

The effective functional independence of the Eurosystem was demonstrated by the speed with which it deployed a panoply of unconventional measures in response to the crisis. The ECB was the first central bank to counter interbank market strains with injections of liquidity, totaling €100 billion already in August 2007.[15] After the default of Lehman Brothers, when the crisis reached a magnitude that prompted fears of the collapse of the entire global financial system, the ECB not only rapidly lowered its policy rates but also introduced fixed-rate, full-allotment auctions for central bank refinancing and broadened the range of assets eligible as collateral. In this way, as early as 2008 the European central bank had expanded its balance sheet by 60 per cent.[16]

In 2009 and 2010, the severe disruption of financial systems produced by the crisis and the consequent recession were compounded, in Europe, by the "sovereign debt" crisis of some euro-area countries. The revelation of the true state of the public finances in Greece resulted in the collapse of international investor confidence – at first just in Greece; but then, in rapid succession, doubts arose over the sustainability of the public debt in Ireland, because of the bursting of the real estate bubble there and the consequent banking crisis, and in Portugal, given that country's persistent macroeconomic disequilibria. Beginning in the summer of 2011, following the announcement of the bail-in of private investors in the restructuring of the Greek debt, the strains turned systemic and spread to Spain, which was suffering a sharp contraction of the real estate market that impacted on the most exposed banks; and lastly to Italy, vulnerable for its large public debt and apparent inability to generate economic growth, even in the longer term.

Up until then, the illusion had prevailed that the Eurosystem could conduct monetary policy simply treating the euro area as a single nation. The doubts voiced by some analysts about the logical consistency of such a model had been muted by the incontrovertible successes of a decade of single monetary policy. Let me recall two of those expressions of doubt: Tommaso Padoa-Schioppa's "currency without a State"[17] and Carlo Azeglio Ciampi's "limp". Ciampi observed that "at the very moment the euro was created, it was born with a limp, an asymmetry between monetary policy and economic policy, the former assigned to the European Central Bank and the latter still largely the province of the national governments. This limp, which we denounced some time ago, is being corrected too slowly."[18] Instead, it was thought that this hobbled Europe was more than good enough to keep up with the swift pace of the modern economy.

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[15] On the morning of 9 August 2007, following the sudden drying-up of trading and the consequent rise in short-term money market rates, the ECB intervened with a fine-tuning operation of one day maturity, allotting some €95 billion to 49 banks. Similar operations were conducted in the days that followed.

[16] Martina Cecioni, Giuseppe Ferrero and Alessandro Secchi (2011), "Unconventional monetary policy in theory and in practice", Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, No. 102.

[17] He used the expression on a number of occasions. For one, see Tommaso Padoa-Schioppa (2004), *L'euro e la sua banca centrale. L'unione dopo l'Unione*, il Mulino, Bologna.

[18] Public address as part of President Ciampi's meetings with political, civil and military authorities in Pistoia, 16 September 2002.

The sovereign debt crisis was a watershed. It made it glaringly clear that the incompleteness of European integration could compromise monetary policy, hindering its transmission between countries and undermining the central bank's functional independence. This for three principal reasons. First, the sovereign debt crisis stirred fears that the euro could break up. An eventuality that until then had been judged to be of probability zero now, in international eyes, entered the sphere of possibility. The consequence, which materialized mostly in 2011, was investors' demand for high premiums on government bonds in the countries of southern Europe. The lack of fiscal union thus came to the fore, and the policy limp could be seen in all its destabilizing potential.

Second, this resulted in an accentuated segmentation of the European financial market along national lines, marking a brusque regression in the laborious process of integration that had been advancing for a decade-and-a-half. The flows of capital between the North and the South of what should be a single currency area were interrupted.[19]

Third, all of this engendered a corresponding segmentation of the banking market. The banks whose balance sheets abounded in the government securities that were under fire in the marketplace were subject to the same fears as their "sovereigns".[20] Everyone knows that banks everywhere tend to have a larger portion of their assets in their home country's government securities.

At the origin of the risks investors suddenly perceived there were also, in the countries under pressure, serious disequilibria that had built up well before the global financial crisis. These weaknesses, varying in extent from country to country, comprised excessive public or private debt, poor competitiveness, dubious prospects for economic growth, and external imbalances. The single currency had shrouded the markets' judgments in a veil of uniformity that was pierced by the sovereign debt crisis, revealing the dissimilarities between the debtor countries. But this must not be allowed to hide the essentially systemic nature of the problems that have struck the entire area.

4. What could the ECB do?

The ECB reacted. In May 2010 it activated the Securities Market Programme for purchases of public- and private-sector securities on the secondary market; the purchases were extended to Italian and Spanish securities in the summer of 2011. In December of that year two longer-term refinancing operations were announced, with the aim of countering the effects that the strains on government securities and capital outflows were having on the wholesale funding of banks in several euro-area countries. In August 2012, amidst resurgent fears of euro reversibility, the ECB announced that it stood ready to carry out outright monetary transactions: secondary-market purchases of government securities issued by countries that agreed to abide by a European programme of financial assistance. To date, no such purchases have been made, nor have the related acts been formally adopted, pending a ruling by the European Court of Justice on the German Constitutional Court's referral. But their announcement alone was enough to calm the markets.

The effectiveness of these measures must not be underestimated. They lessened the tensions in the money and capital markets and averted a sharper contraction in credit, thereby braking the deterioration of the monetary policy transmission mechanism. According

[19] Martina Cecioni and Giuseppe Ferrero (2012), "Determinants of TARGET2 imbalances", Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, No. 136.

[20] Paolo Angelini, Giuseppe Grande and Fabio Panetta (2014), "The negative feedback loop between banks and sovereigns", Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, No. 213.

to studies by the Bank of Italy, the overall effect on Italy's GDP of the measures I have listed can be estimated at a little less than three percentage points in the two years 2012–13.[21]

These measures also highlighted the operational autonomy of the Eurosystem, which was able to bring a wide array of instruments to bear on the different manifestations of the financial crisis, selecting the most suitable one case by case.

However, the success of the ECB's extraordinary measures must not make us forget the difficulties that monetary policy in the euro area has faced in recent years. The global financial crisis and the sovereign debt crisis have brought risks for the Eurosystem's de facto independence that it would be naïve to ignore or underestimate.

I will mention two of them. The first concerns financial autonomy and derives from the fact that the unconventional measures have expanded the size of the ECB's balance sheet, though far less, at present, than those of the US Federal Reserve and the Bank of Japan. The quality of the securities held or accepted as collateral for bank refinancing has declined.

In principle, monetary measures of macroeconomic stabilization can produce both losses and profits for the central bank adopting them.[22] But if a central bank made losses, its reputation would be endangered[23] and its ability to pursue its objectives could be put in doubt; ultimately, there could be mounting political pressure to reduce its independence. This is especially true in the case of the Eurosystem, which not only manages a currency without a state but finds itself facing a multiplicity of states which in these years of crisis have become more sensitive to what divides them rather than strengthening what unites them.

The second, and far more important, risk consists precisely in the incompleteness of the European construction.

Some are calling for amendments to the Treaty in order to expand the ECB's mandate.[24] In particular, on the American example, it is urged that the objective of price stability be flanked by an explicit objective of equal status in terms of unemployment or employment levels; and that the ECB be allowed to purchase government securities directly at issue. Naturally it's not up to me, a central banker, to say what objectives the political institutions should assign to the central bank. But these risk being false solutions to a false problem.

Maintaining a moderate rate of growth in prices in the medium term like that indicated in the ECB's objective equates to ensuring over the same time horizon that the economy operates at its potential, with physical and human capital fully utilized. Assigning the ECB a dual mandate would not imply any step forward. As for government securities purchases on the primary market, in reality this power, which can put the independence of any central bank in jeopardy, is granted to none of the central banks of the advanced countries, not even to those that have undertaken massive programmes of quantitative easing on the secondary

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[21] Marco Casiraghi, Eugenio Gaiotti, Lisa Rodano and Alessandro Secchi (2013), "The impact of unconventional monetary policy on the Italian economy during the sovereign debt crisis", Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, No. 213.

[22] Milton Friedman, "The Case for Flexible Exchange Rates", *Essays in Positive Economics*, University of Chicago Press, 1953, pp. 157–203.

[23] See, for example, Ulrich Bindseil, Andres Manzanares and Benedict Weller (2004), "The role of central bank capital revisited", *ECB Working Paper Series*, No. 392.

[24] For a discussion of the objective of financial stability and the related implications for monetary policy, see Ignazio Visco (2014), "The challenges for central banks", *Quarterly Journal of Central Banking*, Vol. XXV, No. 1.

market, such as the US Federal Reserve and the Bank of England (which is subject to the constraints of the European Treaty).[25]

The real problem is that the euro is a currency without a state. Economic theory and the experience of other monetary unions indicate that, regardless of the formal constraints, this greatly complicates life for those responsible for a single monetary policy, especially when it is a matter of taking unconventional measures that can have significant fiscal and redistributive repercussions.[26] In the absence of a single fiscal authority, some fear a redistribution "by stealth" among countries, not decided by the representative political bodies and carried out via the Eurosystem's balance sheet.

This fear, deeply felt today in the countries of northern Europe, has conditioned the use of the single monetary policy and, when it was a question of designing OMTs, imposed rigid conditionality, so as to prevent cases of "moral hazard" on the part of the countries in greatest fiscal difficulty and ultimately to impede or limit fiscal transfers between states. But what would have happened in all of Europe if in the summer of 2012 President Draghi had not given assurances that the ECB would do "whatever it takes" to preserve the euro?

At the time of the euro's creation, the advisability of accompanying the single currency with a fiscal union was the subject of long debate and there was no lack of contrary opinions, grounded, paradoxically, on the protection of the nascent ECB's independence. Tommaso Padoa-Schioppa wrote in 1999: "The fact of not being accompanied by 'his' minister or 'his' government, may make the ECB President feel more independent and safe from unwelcome influences," however, he hastened to add: "but in the view of the market, the international community and its citizens, "a currency without a state" constitutes an anomaly."[27]

The Treaty would protect the independence of the ECB well even if it faced a single fiscal authority. Indeed, in this case it would be easier to use monetary policy to respond to asymmetrical shocks, shocks hitting one or several countries of the area but not others.

We have made important progress in this direction: the crisis management mechanisms, the reforms of fiscal and macroeconomic governance, and the still to be completed Banking Union.[28] The question remains open: How realistic is it today to imagine further progress towards a fiscal union among the countries that wanted to give themselves a single currency? Is gradual centralization of some public functions conceivable?[29] Or even just greater coordination of national budgetary policies that takes account of the situation of the euro area as a whole?[30]

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[25] From Section 14 (Open-Market Operations") of the Federal Reserve Act: "Notwithstanding any other provision of this chapter, any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to the principal and interest may be bought and sold without regard to maturities but only in the open market."

[26] Kevin H. O'Rourke and Alan M. Taylor (2013), "Cross of Euros", *Journal of Economic Perspectives*, Vol. 27, No. 3, pp. 167–192.

[27] Tommaso Padoa-Schioppa (1999), "Moneta, Commercio, Istituzioni: esperienze e prospettive della costruzione europea", Lecture delivered for the award of an honorary degree in International Trade and Currency Markets Economics, Trieste.

[28] See, for example, Ignazio Visco (2014), "The exit from the sovereign debt crisis: national policies, European reforms and monetary policy", *Lectio magistralis*, Almo Collegio Borromeo, Pavia.

[29] Fabrizio Balassone, Sandro Momigliano, Marzia Romanelli and Pietro Tommasino, "Just around the corner? Pros, cons, and implementation issues of a fiscal union for the Euro area", Banca d'Italia, mimeo.

[30] Interview of Governor Ignazio Visco with Federico Fubini, "Italia, hai poco tempo", *Repubblica*, 7 September 2014.

5. Points of convergence and divergence in Europe today

When the euro was created, the economies that adopted it were marked by differences and divergences. On the one hand was a group of less advanced, rapidly growing, countries with higher rates of inflation, and on the other, the core economies, with slower growth but higher levels of per capita income and basically stable prices. Italy was already in an anomalous situation of lower growth combined with higher inflation.

In its first decade of existence the euro created the conditions for a virtuous, upward, convergence. The last six years of crisis have reversed this trend, in the direction of a "bad equilibrium".

The euro area is on the brink of deflation. In October consumer prices were just 0.4 per cent higher on average than a year earlier. Low inflation is a widespread phenomenon: in only 2 countries out of 18 is the inflation rate above 1 per cent.

The slowdown in prices raises real interest rates, discouraging investment by firms and dampening demand for credit; it also increases the burden of debt service.[31] A falling rate of inflation verging on deflation has particularly serious repercussions for the euro area today: it hinders deleveraging in countries with high public or private debt; it slows the readjustment of relative prices between the various economies, and accordingly the recovery of competitiveness and the elimination of external imbalances where necessary.

These price trends were partly unexpected. They were not just determined by the most volatile component (energy and food) but to a great extent by the weakness of demand. They risk disanchoring long-term inflation expectations. Already today expectations one and two years ahead, measured by swap contracts, are below 1 per cent; they do not approach 2 per cent until well past 2020. Expectations five and ten years ahead are for less low inflation, but still below 2 per cent. The central bank's credibility in meeting the price stability objective is being called into question.

In June and September the Governing Council of the ECB announced a series of new measures including the launch of targeted longer-term refinancing operations (TLTROs) and outright purchases of ABS and covered bonds. The measures are designed to enhance the functioning of the monetary policy transmission mechanism, support lending to the real economy and have a positive effect on the financial markets.

As reiterated by President Draghi, the Governing Council is unanimous in its commitment to using other unconventional instruments within its mandate in order to cope effectively with the risks of an excessively long period of low inflation.

It is important that we do not doubt the central bank's ability to stimulate aggregate demand when this is needed to ensure price stability in the medium term; even less should we doubt the ECB's independence and the strength of the institutional safeguards envisaged under the Treaty: those on the basis of which governments pledged to delegate the conduct of monetary policy and not interfere in it.

There are two possible lines of reasoning in respect of today's situation, one "economic" and one "political". They ought to proceed in parallel but at times they diverge.

The economic line of reasoning provides clear indications to those who are currently responsible for economic policy in the euro area. Almost all economists concur in identifying a serious shortfall in aggregate demand, caused by uncertainty and lack of confidence on the part of firms and households that every day must make investment and consumption decisions. Accordingly, they call for monetary and budgetary policies to be as expansionary

[31] See the box "The risks of low inflation for the financial stability of the euro area", in Banca d'Italia *Financial Stability Report* No. 2, November 2014.

as possible, as well as clear and credible, such as those adopted elsewhere in the advanced world: the United States, Japan and the United Kingdom.

The political line of reasoning appears to indicate a different path. The sovereign debt crisis has roused a sleeping monster in Europe: distrust among nations. This is the most poisonous fruit of the crisis. This mistrust is undoubtedly based on objective truths. Northern countries in particular rebuke their Southern neighbours for reckless public expenditure over the years, the many wasted opportunities to reform their economies and make them competitive again. These views are widely held by public opinion in these countries, whose rulers – democratically elected political leaders – must take them into account. The result is a strong insistence on balanced public accounts: in the indebted countries so that they can be consolidated and in the financially sounder countries because they should set a good example. In all the euro-area countries opinion groups hostile to the euro and the European edifice are gaining traction.

In the area's current cyclical conditions this kind of political thinking, which evokes sound principles of social rigour and public morality, risks, however, contradicting the economic line of reasoning and producing long-lasting damage for the entire area.

Monetary policy ought to be protected from this clash of economic and political reasoning by the same statute of independence attributed to the European System of Central Banks, which is responsible for its implementation. Until now this system has acted consistently. The internal debate within the Governing Council of the ECB that is occasionally made public is natural in any collegiate body. It is in the interest of all Europeans that its independence continue to be defended from within and seen favourably from without.

However, the political line of reasoning cannot be ignored. The structural reforms in the euro-area countries that have lagged behind in competitiveness, Italy to start with, are vital for two reasons: the first is that they are the only way to unblock the jammed mechanisms of economic development; the second, equally important, is that they help to increase trust among nations. If the present diffidence should put down roots the entire European construction would be in peril.

I would like to conclude with another enlightening reference to Carlo Azeglio Ciampi, when he delivered a speech celebrating the euro's entry into circulation: "The single currency is above all the result of a desire for cohesion which, along with continuity and consistency of ideals, are the driving force of Europe. Cohesion is our greatest asset: it must however be willed, and it must have an identity, and a structure that is also institutional."[32]

[32] Speech by the President of the Republic, Carlo Azeglio Ciampi, delivered on 26 November 2001.